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## Agenda Item 6a

April 12, 2011

### TO: MEMBERS OF THE FINANCE COMMITTEE

- I. SUBJECT:** Fiscal Year (FY) 2011-12 Budget Proposals (Second Reading)
- II. PROGRAM:** Administration
- III. RECOMMENDATION:**
- (1) The Committee accept the proposed California Public Employees' Retirement System (CalPERS) FY 2011-12 Administrative Budget of \$334,196,000 and 2,366 positions, and recommend the Board of Administration (Board) approve the Budget as a second reading.
  - (2) The Committee accept the proposed CalPERS FY 2011-12 Enterprise Projects Budget of \$43,011,000, and recommend the Board approve the Budget as a second reading.
  - (3) The Committee accept the proposed FY 2011-12 CalPERS Headquarters Building Account (Building Account) Budget of \$42,611,000, and recommend the Board approve the Budget as a second reading.
  - (4) Approve the transmittal of this agenda item to the Joint Legislative Budget Committee, fiscal committees of the Legislature, State Controller, and Department of Finance, in accordance with the Budget Act of 2010, and to the Legislative Analyst's Office, State and Consumer Services Agency, and the Office of the Legislative Counsel.

### IV. ANALYSIS:

#### Summary

During the FY 2010-11 Annual and Mid-Year processes, the CalPERS Administrative Budget was approved for one-time reductions totaling \$18,465,000 and a transfer of budget authority to the Enterprise Projects Budget

to fund the Pension System Resumption (PSR) Recovery plan. This resulted in a one-time decrease from the FY 2010-11 beginning Administrative Budget of \$334,196,000 to the FY 2010-11 Mid-Year level of \$315,731,000.

Reinstatement of the one-time reductions of \$18,465,000 will restore CalPERS FY 2011-12 Administrative Budget to the FY 2010-11 base budget of \$334,196,000. There is no proposed increase to the Administrative Budget above the reinstatement of this one-time funding, even though there are staff recommendations for Formal Budget Requests, technical adjustments, and the return of prior year redirections to divisions.

In addition, Staff recommends the establishment of 36.0 new positions. This will increase CalPERS overall positions from 2,330 to 2,366 authorized positions.

### **Background**

As a result of California's declining fiscal situation, CalPERS Executive and Senior Leadership committed to a zero-growth budget in the FY 2008-09 Mid-Year cycle. This commitment entailed reallocating existing resources to meet identified critical and unforeseen budget needs. CalPERS Executive Leadership continued a similar and more extensive path for the FY 2009-10 and FY 2010-11 Budget processes. Through the redirection of resources, the FY 2010-11 Annual process resulted in a one-time reduction to the Administrative Budget of \$3,000,000 to fund a portion of the PSR Go Forward Strategy, and a one-time reduction of \$15,465,000 to the Administrative Budget in the FY 2010-11 Mid-Year process to fund the PSR Recovery Plan. These two one-time reductions total \$18,465,000.

CalPERS Executive and Senior Leadership met to carefully prioritize and substantiate the resource requests for the FY 2011-12 Budget Year. CalPERS staff recognizes that zero growth and prior redirection of Enterprise resources to fund new and critical initiatives creates challenges for many CalPERS divisions. Consideration was given to the Enterprise's ability to fund critical needs utilizing existing resources without negatively impacting divisions, along with the impact of postponing or reprioritizing workload, and the impact of deferring requests to a future budget cycle. Based on this review, and with the restoration of \$18,465,000 in one-time reductions from FY 2010-11, CalPERS will be able to fund resource needs without an increase to the Administrative Base Budget of \$334,196,000 for the FY 2011-12 Annual process.

As detailed further in the Formal Budget Request section, 36.0 positions are requested above the current level with funding reallocated from CalPERS available resources, thereby avoiding any increase above the FY 2011-12 Administrative Base Budget.

The recommended Enterprise Projects Budget is \$43,011,000 and the Building Account Budget is \$42,611,000 for FY 2011-12. Shown in Table 1, the proposed FY 2011-12 budget for all budgetary categories is \$1,549,429,000 and 2,366 authorized positions. There is no recommended change in the proposed budget from what was approved in the first reading.

Table 1

Category	Budget	Positions
Administrative Budget	\$334,196,000	2,366
Enterprise Projects Budget	43,011,000	
Building Account	42,611,000	
Investment Expenses*	1,029,681,000	
Third Party Administrative Fees*	99,930,000	
<b>Total</b>	<b>\$1,549,429,000</b>	<b>2,366</b>

\* Information Only

Additional information regarding the \$1,549,429,000 proposed budget is displayed on Attachment 1.

Staff recommends approval of the Administrative, Enterprise Projects, and Building Account Budgets. An analysis of these three proposed Budgets is presented in the following sections.

Following these three sections, a description of projected Investment Expenses and Third Party Administrative Fees is provided. Projections for these two categories are presented for informational purposes only.

#### **A. ADMINISTRATIVE BUDGET**

There is no recommended change in the proposed Administrative Budget from what was approved in the first reading. Although there were resource requests for FY 2011-12, there is no proposed increase to the Administrative Budget above the reinstatement of one-time reductions of \$18,465,000 from FY 2010-11. The reinstatement of one-time funding will restore the Administrative Budget to a current-year beginning level of \$334,196,000.

The Formal Budget Request Process identified 36.0 positions as being critical to Enterprise needs. CalPERS staff recommends establishing these 36.0 positions, which would result in an increase in CalPERS current authorized positions from 2,330 to 2,366.

CalPERS Executive Leadership opted to address new funding priorities through the reallocation of available resources, or by deferring requests, to ensure no increase to the Administrative Budget for the FY 2011-12 Annual Budget process. The available resources will be reallocated to address both urgent Enterprise priorities identified in the Formal Budget Requests totaling \$9,585,450, and a partial reinstatement of prior year redirections back to the divisions in the amount of \$8,433,000. Additional information regarding Formal Budget Requests is below.

### **Formal Budget Requests**

Resource requests for the proposed FY 2011-12 Budget are the result of an annual planning and analysis process coordinated by the Strategic Management Services Division.

The Annual Planning process began in October 2010 with the development of Concept Papers. Consideration was given to the Enterprise's ability to use existing resources, the impact of postponing or reprioritizing workload, and acknowledgment of the State's ongoing financial situation. The objective was to assess Enterprise priorities and request minimal resources to achieve CalPERS Business Plan goals in FY 2011-12 without jeopardizing the Enterprise's ability to provide necessary service levels, increase transparency and accountability, and manage risk in our investment portfolio and operations.

The Concept Papers were submitted to the Strategic Management Services Division. The initial requests were \$17,815,538 and 88.0 permanent positions (see Attachment 2.0). During the Annual Planning process, CalPERS Division Chiefs met to evaluate and carefully prioritize these resource requests to see where reductions could be made. Of the Concept Papers submitted, Division Chiefs agreed and recommended approval of \$15,784,200 and 62.0 permanent positions to Executive Leadership (see Attachment 2.1). Deputy Executive Officers and Assistant Executive Officers met with Division Chief Representatives and approved the recommendation of \$15,784,200 and 62.0 permanent positions to be submitted as Formal Budget Requests. Subsequently, there were two additional requests submitted, increasing the Formal Budget Requests received by the Budget Management Section to \$19,228,200 and 65.0 permanent positions.

The Budget Management Section evaluated the Formal Budget Requests for proper workload justification, critical nature of the request, resources received from prior budget processes, and the ability to fund these needs through existing resources. The critical nature of the requests were based on whether they were directly related to PSR, new legislation, risk initiatives, impact to pensions, technology needs, consultant savings, long-term investment strategies, or

administrative workload. After completing this analysis, Budget Management Section staff recommended approval of Formal Budget Requests totaling \$9,585,450 and 36.0 authorized positions, which includes one-time funding of \$5,177,450 and ongoing funding of \$4,408,000 (see Attachment 2.2).

Budget Management Section staff has identified resources from within the Enterprise to fund these requests, in an effort to maintain zero growth for the FY 2011-12 Annual Process. There were \$9,642,750 and 29.0 authorized positions requested that were not recommended for approval (see Attachment 2.3).

The recommendation of 36.0 authorized positions will increase CalPERS current authorized positions from 2,330 to 2,366. A summary of budgeted positions is included in Attachment 5.

### **Return of prior year redirections**

Of the available resources, \$8,433,000 is proposed to be reallocated back to divisions. The \$8,433,000 represents a portion of divisions' Personal Services budget that was redirected in prior years to fund critical Enterprise priorities, including PSR, while maintaining a zero growth environment. Many divisions are facing challenges absorbing the reduction in their Personal Services while continuing to maintain low vacancy rates. It is important to ensure the impact to Personal Services is mitigated in light of these factors, as well as with any changes due to the Organizational Structure and Processes Initiative. Since this reallocation represents only a portion of prior year redirections back to divisions, CalPERS will be reassessing the Personal Services budget after the new organizational structure is in place.

### **Technical Adjustments**

The proposed FY 2011-12 Administrative Budget includes \$7,299,000 in technical adjustments. These technical adjustments include items such as increases to health and dental premiums, retirement, data processing services, the cost of processing retirement warrants, merit salary adjustments, and charges to CalPERS from State control agencies.

## **B. ENTERPRISE PROJECTS BUDGET**

There is no recommended change to the Enterprise Projects Budget from what was approved in the first reading. The proposed FY 2011-12 Enterprise Projects Budget is \$43,011,000, which includes funding for PSR Recovery Plan and Releases 2 and 3. This encompasses \$35,444,000 for PSR, \$4,983,000 for the Enterprise Transition Management (ETM) Project and \$2,584,000 for Financial

Services Integration Project (FSIP). More information on these projects is displayed in Table 2.

Table 2

FY 2011-12 Enterprise Projects Recommended Budget				
	Original PSR Budget	PSR Recovery Plan	PSR Release 2 & 3	Total
PSR:				
Accenture Contract	\$8,037,000	\$0	\$0	\$8,037,000
Contract Staff	0	6,055,000	8,125,000	14,180,000
Backfill Resources	0	3,116,000	7,017,000	10,133,000
Independent Project Oversight	0	1,620,000	168,000	1,788,000
Consulting				
State Staff and Operating Costs	472,000	48,000	252,000	772,000
Employer Training	0	284,000	0	284,000
Legal Costs	0	250,000	0	250,000
<b>Subtotal</b>	<b>8,509,000</b>	<b>11,373,000</b>	<b>15,562,000</b>	<b>35,444,000</b>
ETM:				
Contract Staff	0	3,228,000	643,000	3,871,000
Independent Project Oversight	0	729,000	0	729,000
Consulting				
State Staff and Operating Costs	0	241,000	142,000	383,000
<b>Subtotal</b>	<b>0</b>	<b>4,198,000</b>	<b>785,000</b>	<b>4,983,000</b>
FSIP:				
Contract Staff	0	775,000	1,809,000	2,584,000
<b>Subtotal</b>	<b>0</b>	<b>775,000</b>	<b>1,809,000</b>	<b>2,584,000</b>
<b>Total</b>	<b>\$8,509,000</b>	<b>\$16,346,000</b>	<b>\$18,156,000</b>	<b>\$43,011,000</b>
<b>Total Enterprise Projects FBR Request</b>	<b>\$24,855,000</b>		<b>\$18,156,000</b>	<b>\$43,011,000</b>

### C. CalPERS HEADQUARTERS BUILDING ACCOUNT BUDGET

There is no recommended change to the Building Account Budget from what was approved in the first reading. The Building Account represents the operating expenses associated with the CalPERS Headquarters Complex (Lincoln Plaza North, Lincoln Plaza East and Lincoln Plaza West), the Emergency Operations Center, 1800 3<sup>rd</sup> Street property, and 1800 7<sup>th</sup> Street property.

Staff recommends approval of \$42,611,000 for the FY 2011-12 proposed Building Account Budget which represents a \$9,694,000 increase, or 29.4 percent, compared to the FY 2010-11 Budget of \$32,917,000. The increase is primarily due to building improvements for 1800 3<sup>rd</sup> Street property.

Table 3 displays the categories that comprise the proposed FY 2011-12 Building Account Budget.

Table 3

<b>Building Account Categories</b>	<b>Amount</b>
Operating Expenses	\$22,200,000
Non-Operating Expenses	15,226,000
Facilities Support	5,185,000
<b>Total</b>	<b>\$42,611,000</b>

Attachment 7 provides additional information about the proposed Building Account Budget.

#### **D. INVESTMENT EXPENSES**

There is no recommended change to projected Investment Expenses from what was presented in the first reading. Projected Investment Expenses for FY 2011-12 are \$1,029,681,000. These expenses include base and performance fees for external investment advisors. The costs associated with the master custodian, portfolio management services, real estate appraisal fees, and investment-related legal and audit fees are also included in this projection.

Attachment 8 provides additional information about Projected Investment Expenses and provides prior year actual Investment Expenses as reported in the Comprehensive Annual Financial Report.

#### **E. THIRD PARTY ADMINISTRATOR FEES**

There is no recommended change to the projected Third Party Administrator Fees from what was presented in the first reading. Third Party Administrators are responsible for the management of all aspects of the administrative services provided to the Long-Term Care program, the Self-Funded Health program, and Supplemental Income Plan. This includes, but is not limited to the development, training, coordination, monitoring and oversight of all systems, procedures, manuals and personnel that are necessary for the efficient and cost effective delivery of all contracted services. Services provided include underwriting/issuance, billing, advisory services, claims administration, customer service, records maintenance, and enrollment. Estimated Third Party Administrator fees for FY 2011-12 are \$99,930,000. Attachment 9 provides additional information about Third Party Administrator fees.

## **V. STRATEGIC PLAN:**

This item is not a specific product of the Strategic Plan. It is brought to the Finance Committee and the Board to satisfy the following requirements: (1) obtain approval of FY 2011-12 Annual Budget revisions; and (2) fulfill Budget Act control language requirements.

## **VI. RESULTS/COSTS:**

Staff recommends approval of an Administrative Budget of \$334,196,000 and 2,366 authorized positions. The Administrative Budget represents a restoration of one-time reductions from FY 2010-11 totaling \$18,465,000, and recommendation to approve 36.0 positions to be established. In addition, staff recommends the approval of \$43,011,000 for the Enterprise Projects Budget and \$42,611,000 for the Building Account Budget. If accepted by the Finance Committee and approved by the Board at the April 13, 2011, meeting, the FY 2011-12 Budget will take effect July 1, 2011.

In accordance with control language included in the Budget Act of 2010, the information contained in this agenda item will be submitted to the Joint Legislative Budget Committee and the fiscal committees of the Legislature, State Controller, and the Department of Finance. It will also be provided to the Legislative Analyst's Office, and Secretary of the State and Consumer Services Agency. Submitting this agenda item will take place upon acceptance by the Finance Committee and approval by the Board. A draft transmittal letter is attached for your review.

## **A. ATTACHMENTS**

The following attachments contain details for the FY 2011-12 proposed budgets/projected expenditures:

Attachment 1	Proposed FY 2011-12 Budget
Attachment 2.0	FY 2011-12 Concept Paper Original Requests
Attachment 2.1	FY 2011-12 Concept Papers Approved to Move Forward as Formal Budget Requests (FBR)
Attachment 2.2	FY 2011-12 Annual FBRs Recommended For Approval
Attachment 2.3	FY 2011-12 Annual FBRs Recommended for Disapproval
Attachment 3	Administrative Budget Summary by Object of Expenditure
Attachment 4	Budget by Fund Source
Attachment 5	Summary of Budgeted Positions
Attachment 6	Budgets by Basis Points
Attachment 6.1	Six Year Basis Points History
Attachment 7	CalPERS Headquarters Building Account Budget



Attachment 8	Projected Investment Expenditures
Attachment 9	Third Party Administrator Fees
(Also included)	Draft Transmittal Letter

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